UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF VIRGINIA
ALEXANDRIA DIVISION

STEVEN KNURR, et al	:	
Plaintiffs	:	
versus	:	Civil Action Number
ORBITAL ATK INC., et al	:	1:16-CV-1031
Defendants.	:	

December 8, 2017

The above-entitled Motion to Dismiss was continued before the Honorable T.S. Ellis, III, United States District Judge.

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P R O C E E D I N G S

THE DEPUTY CLERK: Steven Knurr, et al. v. Orbital ATK, Inc., et al., Civil Case Number 16-CV-1031.

THE COURT: All right. Who is here for the plaintiffs?

MR. BARZ: Good morning, Your Honor. Jim Barz, B-A-R-Z, on behalf of the plaintiffs.

MR. REILLY: Also, liaison counsel for the plaintiffs, Craig Reilly, Your Honor.

THE COURT: Yes. Good morning to both of you. And I'll tell you, Mr. Barz, Mr. Reilly is, of course, very experienced in this court, knows it well. However, you don't always have to have counsel with you if -- you may make that choice. You and Mr. Reilly may make that choice.

You may decide, and Mr. Reilly may counsel you always to have him here, which is sensible, but I give you leave to ask the Court not to have liaison here. It's up to you.

MR. BARZ: I appreciate that, Your Honor. And in certain matters, I may avail myself of that. I find his advice valuable and necessary.

THE COURT: Yes, of course. All right. For the defendants, who is here for the defendants?

MR. ROBERTS: Yes, Your Honor. Lyle Roberts with

the Cooley Firm on behalf of Orbital ATK and the individual defendants, other than Mr. DeYoung. And I'm joined today by my colleague, George Anhang.

THE COURT: All right. And then who is here for the new defendant, as it were?

MR. ROBERTS: I -- I am, Your Honor. Lyle Roberts with Cooley representing Mr. Hollis Thompson.

THE COURT: All right, well --

MR. RABINOVITZ: And, Your Honor, my name is Joshua Rabinovitz, and I'm here on behalf of Mark DeYoung, who is an existing defendant.

THE COURT: I see. Right. And -- well, refresh my recollection, Mr. Rabinovitz, your client was a -- an ATK or an Alliant employee?

MR. RABINOVITZ: He was an officer of Alliant and then a director of Orbital ATK.

THE COURT: But he's no longer either of those?

MR. RABINOVITZ: Correct, Your Honor.

THE COURT: All right. Thank you. All right. You may be seated.

A brief recitation might be helpful in this regard. This is not the first appearance of this case. It's a 10b-5 -- essentially, 10b-5. There was another claim in there, a case involving an allegation of securities fraud against the defendants.

In essence, the defendants are alleged to have made fraudulent statements in their 10-Ks. The essence of the fraud is that they significantly understated what the profits would be with respect to a contract that it had for manufacturing small arms ammunition.

That -- was it Lake Charles contract?

MR. BARZ: Lake City.

THE COURT: Lake City. And where is Lake City?

MR. BARZ: Missouri.

MR. ROBERTS: Yes, Your Honor, in Missouri.

THE COURT: Missouri. All right. And we had a first round in which there was a Motion to Dismiss filed by the defendants. I ruled on that by way of a written opinion in which I granted the Motion to Dismiss as to the individual -- all defendants, and gave the plaintiff leave to amend the complaint.

I found that the complaint, although it was lengthy, conveyed a lot of information in it, did not meet the statutory requirement of alleging a strong scienter -- a strong inference of scienter. That is knowledge that the 10-Ks -- 10-KTs were false.

The amendment adds a defendant and some additional allegations. The defendant that's added was -- is someone who had supervisory and accounting policy. His name is Hollis Thompson.

And you do represent Mr. Thompson?

MR. ROBERTS: Yes, correct, Your Honor.

THE COURT: All right. So I have read the briefs and thought about this. I want to give you, first, an unfettered opportunity to argue. You shouldn't repeat what's in -- don't need to repeat what's in your brief. You may repeat what you wish. You may underscore what you think I need to understand, but I have read the briefs. And in the interest of -- or a concession to the shortness of life, I ask you to keep it reasonably focused.

So I'll hear first from the party with the burden, which is the defendants. And you may proceed.

MR. ROBERTS: Good morning, Your Honor. Thank you. As Your Honor notes, all of the claims -- the securities fraud claims against the individual defendants were dismissed. The plaintiffs are not challenging those dismissals. And they haven't added any new allegations concerning those individual defendants in their amended complaint. What they have done is added a new defendant, Hollis Thompson. And Hollis Thompson, as Your Honor noted, was a vice president of Financial Reporting and was the principal accounting officer of Orbital ATK.

According to plaintiffs' new theory of the case, Mr. Thompson is at the center of the alleged fraud because he supposedly knew about an erroneous accounting policy and the

underestimation of costs associated with the Lake City contract.

There was a reason, however, Your Honor, why that theory was not in their original complaint. And it's because it simply doesn't make any sense.

First, Mr. Thompson worked for Orbital Sciences, not Alliant Technology. So he wasn't involved with the bidding or the startup of the Lake City Contract, which took place prior to the merger of the two companies.

Second, Mr. Thompson is not alleged to have and did not have any supervisory role as to the Lake City operations.

Third, the erroneous accounting policy was developed by Alliant, not Orbital Sciences. And it was fully disclosed to the company's investors. To the extent that Mr. Thompson has argued to have approved the erroneous policy, he wasn't alone. The auditors -- the auditors for both companies also approved this erroneous policy.

Fourth, plaintiffs don't allege that Mr. Thompson had any information about the cost estimates for the Lake City contract that wasn't possessed by the other individual defendants as to whom these claims have already been dismissed. Nor could they make that allegation given that lower level employees didn't escalate negative information about the Lake City contract to Orbital ATK's senior management, which obviously included Hollis Thompson. He's a

member of senior management, as the plaintiffs concede.

Finally, plaintiffs provide no motive for Hollis Thompson to have defrauded the company's investors. They don't allege that he profited from the alleged fraud in any way, not through stock sales, not through bonus compensation, anything.

So I think on one side, Your Honor, we have a fairly overwhelming inference of non-fraudulent conduct on the part of Hollis Thompson. Mr. Thompson was a member of senior management. But for the reasons I just cited, the scienter allegations against him are actually weaker than the allegations against the other individual defendants that this Court has already dismissed from the case.

So the plaintiffs' response to this, I think, really obvious and holistic conclusion about the strength of their scienter allegations is that it should be overturned by the fact that they've put in two additional allegations in their amended complaint.

The first is that Hollis Thompson, again, approved an erroneous accounting policy. The second is that Hollis Thompson was replaced by the -- as the company's principal accounting officer after it issued the restatement, an issue in this case.

As Fourth Circuit precedent so amply demonstrates here --

THE COURT: And the third allegation, that he's a CPA or that he knows all about accounting.

MR. ROBERTS: That's right, Your Honor. I think that's part of their allegations concerning the erroneous accounting policy.

THE COURT: All right. Go on.

MR. ROBERTS: So as Fourth Circuit precedent amply demonstrates, these allegations simply don't move the scienter pleading needle.

Let me turn just first briefly to this allegation that you just pointed out about it proving the erroneous accounting policy at Mr. Thompson's knowledge of accounting in general.

As background, Your Honor, that policy involved general administrative costs. So what are those? Those are the indirect costs that are incurred in the general operation and management of the business as a whole. Prior to the restatement, Orbital ATK did not consider such costs when it calculated losses associated with the contract.

And when it issued its restatement, the company informed investors that the policy had been incorrect and that these indirect costs should have been included and will be included going forward.

But here is the rub, Your Honor. The existence and use of the erroneous accounting policy was public knowledge.

Orbital ATK accurately disclosed the policy it was using. And the company's investors therefore understood that the company was not considering these indirect costs when it was making these accounting deliberations.

THE COURT: When you say "disclosed," do you mean in the 10-Ks?

MR. ROBERTS: Correct, Your Honor.

THE COURT: All right. Go on.

MR. ROBERTS: Under these circumstances, this Court has already held in other cases and in this case. This was not a hidden red flag that could contribute to an inference of scienter as to Mr. Thompson.

More fundamentally, Your Honor, plaintiffs' argument is that the Court should infer that because one of the accounting policies was incorrect and because Mr. Thompson was an accountant, he must have known that this policy was incorrect.

As a factual matter, Your Honor, I think that's beggar's belief, because it's uncontested that the Orbital -- Orbital ATK's outside auditors also didn't recognize this error. So it's hard to understand how Mr. Thompson must have known about an error that the outside auditors didn't pick up on either.

Moreover, as a legal matter, courts have routinely rejected the assertion that GAAP violations can create strong

inference of scienter. And it's with good reason, Your Honor, because GAAP is very complicated. There are 19 different GAAP sources. Sources are often unclear. Even very experienced accounting professionals make mistakes when it comes to interpreting GAAP. And that's a far cry -- making a mistake in doing that is a far cry from deceiving -- trying to deceive investors.

I think, Your Honor, what's really going on here is, at best, the plaintiffs are asking the Court to do something that the Fourth Circuit actually just rejected a few weeks ago in its *PowerSecure* decision, which we've provided to the Court.

As the Fourth Circuit explained in that decision, under Fourth Circuit precedent, a plaintiff cannot allege facts that permit an inference that the defendant knew his statement was false, and then ask the Court to infer from that inference that the defendant acted with scienter.

Similarly, that's what plaintiffs are trying to do here. They're asking Your Honor to infer that because Mr. Thompson knows about accounting and because he was in senior management, he must have known that the accounting policy was erroneous. And then the Court should then infer that he approved this erroneous accounting policy to perpetuate a fraud on the company's investors.

And we think, Your Honor, that just as in

PowerSecure, this Court should decline that invitation. And I would just quote what the Fourth Circuit said here in terms of analyzing this sort of thing. It said, "Stacking inference upon inference in this manner violates the PSRA's mandate that the strong inference of scienter be supported by facts, not other inferences." And that's what going on here.

When you make a must have known allegation, Your Honor, you're just asking the Court to infer something and then infer from that that there is scienter.

Just turning briefly to the other scienter allegation they made here, Your Honor, Mr. Thompson's replacement as the principal accounting officer following the restatement, that's similarly deficient.

Your Honor, I think it's helpful here to begin with exactly what the company actually said. On February 27, 2017, the company's board of directors elected Chris A. Voci as the company's vice president and controller. And this is what they said in their AK: Mr. Voci replaced Hollis Thompson as the company's principal accounting officer.

So based on this one-line disclosure, plaintiffs contend not only did Orbital ATK terminate -- that's their word -- Hollis Thompson, but the company did so because he knew about or recklessly disregarded the true costs associated with the Lake City contract.

There's no factual support for those contentions,

Your Honor.

Hollis Thompson was not one of the lower level employees that the company disclosed its suppressed information. To the contrary, he's a member of senior management. He's the person the information is being suppressed from. And --

THE COURT: And I think you pointed out that he wasn't around when these lower people were concealing information.

MR. ROBERTS: Well, certainly for a large portion of that period, Your Honor, because he is at Orbital Sciences. He only comes on board when the companies merge in 2015.

And the other thing that the plaintiffs point to is a June 30, 2017 presentation to investors. And that also doesn't suggest that Hollis Thompson acted inappropriately. That presentation, which we provided to the Court in full, so the Court could review it, has a section on causes of the restatement --

THE COURT: You're not arguing that he acted appropriately or inappropriately. You're saying that doesn't warrant an inference that he acted fraudulently.

MR. ROBERTS: That's correct, Your Honor.

THE COURT: All right.

MR. ROBERTS: And certainly there is a section in that presentation that talks about causes of the restatement,

and I assure you that Hollis Thompson's name does not show up in that section. He's -- that is not something the company did despite the way the plaintiffs attempt to characterize that document in their papers.

So, again, I think, Your Honor, without any facts to support this theory about Hollis Thompson's supposed termination, again, it's just an impermissible stack of inferences that the plaintiffs are asking the Court to draw here.

But, Your Honor, I would note something, even if the plaintiffs were correct here, even if they were right that Hollis Thompson was terminated as a result of the restatement, the Fourth Circuit has made it clear that this would be insufficient to establish an inference of scienter.

And this is the *Yates* case, Your Honor, and the Fourth Circuit really couldn't have been clearer about this. The Fourth Circuit stated that where a corporate official leaves the company, before or slightly after a financial restatement, the reasonable assumption -- quoting now -- the reasonable assumption is that this occurred because the company faced substantial accounting challenges, not that the officer participated in a fraud and plaintiffs have the burden of alleging facts to the contrary.

And that rule makes perfect sense, Your Honor. There's a reason why the Fourth Circuit has adopted it. It

makes perfect sense because, of course, companies have a shuffling in their management when they announce bad news, and there is a large stock price decline. That happens all the time. If we allowed plaintiffs to stand up and say the fact that's -- an officer has been replaced as the principal accounting officer is now evidence of scienter that can create inference of fraudulent intent. We would have -- these cases would go forward all the time. They don't because that's not sufficient and Fourth Circuit is clear it's not sufficient.

So, Your Honor, in sum, I would say neither of plaintiffs' new scienter allegations provide any support for the inference that Hollis Thompson intentionally concealed the losses on the Lake City contract or with severe recklessness failed to recognize those losses.

And that, Your Honor, is what you described correcting as the "missing essential ingredient" as to the claims against the other individual defendants. And it's missing as to Hollis Thompson as well.

So, consequently, when we look at all of this holistically as, of course, the Court is required to do, plaintiffs' allegations don't support a compelling inference that Hollis Thompson intentionally or recklessly deceived Orbital ATK's investors. And the Court should dismiss these newly discovered claims just as it dismissed the claims against the other individual defendants here.

Your Honor, I'll just take a brief moment on corporate scienter, which is something that the plaintiffs have raised again.

I would note, Your Honor, that this issue has been argued extensively before this court. It was argued in Computer Sciences case. This court came to a decision. Your Honor --

THE COURT: Yes, but tell me about what other courts now say about it. I know that I have said something about it in the past, but we live in a dynamic age. I have -- I'm in a age now where I reminisce a good deal. Reminiscing is more profitable at my age than looking ahead.

I remember as a young lawyer attending an argument in London at the House of Lords, which then was essentially their Supreme Court. Everything has changed now. But it was an antitrust case. And the argument went on for almost six weeks. I was only there for about two. Wonderful advocacy. Very articulate. No written briefs at all. They mentioned cases, and then they and the judges who were dressed in regular suits would march up to the bookcase, they'd pull books out and together they would pour over the books. Counsel were robed and wigged. And they would do it all from memory. The world has changed.

I used to -- when I first went on the bench 30-plus years ago, there were no -- there were some computers, but

what a judge said was not recorded forever, in an -- in an easily accessible way. Now, you and your opponents have been able to delve into everything I've written in the past 30 years. So I know I've written on this. I think it's better today than it was then. It causes me to try to be a bit more careful about what I say in these opinions.

But this issue of corporate liability boils down to this, and I do very much want to hear what both of you have to say on this.

What we do know from the complaint, and I think it's conceded by the defendants is that Orbital, after the merger, and really before with Alliance, but we do know that some folks down the corporate ladder concealed information and did not report to the more senior people.

The question is: If the senior people cannot be accused of scienter or cannot be accused of fraud with the requisite allegations of scienter, can the corporations still be held accountable under 10b-5, because the corporation, in effect, signed 10-Ks and someone, perhaps down farther on the ladder, didn't say what they should have said to the upper people and so, the -- the plaintiff would say the 10-K operated as a fraud on investors.

So now the question is, let's assume, hypothetically that the complaint cannot allege scienter with the requisite strength -- and let's be clear about the strength. The

strength is -- it has to be a strong inference of scienter, but then in the *Tellabs* case, the Supreme Court defined that as being an inference that is no less compelling than the opposite inference. Amusing to me.

But in any event, I see it as an attempt to erase what Congress -- but in any event, the law is the law. And I must enforce it or apply it regardless of what my own personal views are. And I really don't have personal views about that. I have lots of other things I prefer to think about.

But in any event, I want to know, let's assume that there isn't a high corporate executive who signed the 10-Ks and everything that could be accused of having the strong -- or having accused -- being -- having facts that would warrant accusing that person of having a strong scienter, why shouldn't the corporation nonetheless have to answer for the false information that was in the 10-Ks?

MR. ROBERTS: Well, Your Honor --

THE COURT: Never mind what I've said in the past.

MR. ROBERTS: I won't. The good news, Your Honor, that as -- as you say, the law does evolve and what we have now is a Supreme Court decision that answers that question.

THE COURT: All right.

MR. ROBERTS: So I think -- I think -- I think that's the short way of putting it. And let me expand on it a little bit.

The holding that Your Honor had made previously was that corporate liability for securities fraud depends on at least one of its agents making a false or misleading statement with scienter.

That holding is consistent with the general principals of corporate liability. It's based really on two simple premises. First, as the Fourth Circuit has repeatedly said, only the scienter of employees who act with the necessary scienter can be imputed to a corporation. In other words, as the Second Circuit held in its *Dynex* decision -- and I'm quoting here, Your Honor -- "To prove liability against a corporation, of course, the plaintiff must prove that an agent of the corporation committed a culpable act with the requisite scienter." What's the culpable act?

THE COURT: Well, didn't these lower people commit an act?

MR. ROBERTS: A culpable act, Your Honor, and the act has to be the securities fraud. There -- it must be where they were liable for securities fraud --

THE COURT: So most of these people knew, I mean, as they might well know that the corporation has to report the figures that they are reporting. And so they know that 10-Ks, in effect, have to be signed.

MR. ROBERTS: But the Supreme Court answered the question, Your Honor, whether that type of employee can be

culpable for securities fraud. What the Supreme Court said in *Janus Capital Group v. First Derivative Traders* is that the only people who engage in a culpable act for purposes of securities fraud are those who make a misstatement by the possessing ultimate authority over that statement.

That's the -- that's the Supreme Court limitations. The Supreme Court has decided --

THE COURT: That sounds consistent with what I've said in the past.

MR. ROBERTS: It -- absolutely consistent, Your Honor. So the Supreme Court has limited the scope of what kind of corporate officials can be liable for securities fraud.

And so having made that limitation, it cannot be at the lower level -- level place --

THE COURT: So the corporation has -- is not subject to being called to answer for making a false statement in its 10-Ks just because the people who made the statement didn't know the facts and people farther down failed to disclose -- deliberatively failed to disclose by concealing the facts that would have alerted the -- the signing officials?

MR. ROBERTS: Well, Your Honor, if -- if we had a different type of statute we were talking about. If we were talking about a negligence-based statute, a statute for, you know, mismanagement, all of those things might be possible,

but what we're talking about here is securities fraud. So for purposes of securities fraud, you have to have one individual who both engages in the act and has the requisite mental state. That's simply just clear in the laws. The Supreme Court has made it pretty clear in *Janus* as well. So a different type of claim perhaps, but not this type of claim.

THE COURT: Well, we might all think that having a negligent standard would be appropriate, but I have to tell you if we had a negligent standard for corporate people, we'd have to open new courthouses and appoint hundreds of new judges.

MR. ROBERTS: You're absolutely right, Your Honor. So, Your Honor --

THE COURT: Anything else?

MR. ROBERTS: Well, based on this combination of what circuit courts have said, what Supreme Court has said in *Janus* only the scienter of individuals who make the statement -- who have ultimate authority over the statements that are alleged, have been false or misleading, only their scienter can be imputed on the company. And that's clearly not what we have here. These lower level employees didn't have ultimate authority over the public disclosures at issue.

And I would just note, Your Honor, that the -- what the plaintiffs have done here to try to overcome that is they've cited a pre-*Janus* case called *Southland* from the Fifth

Circuit. And they've said, well, in that case the Court found that individuals who furnished information, that gets folded into public statements, their scienter can be imputed to the company.

And, Your Honor, I would say that two things about the *Southland* decision. One, the South -- what the Fifth Circuit said in *Southland* was that its holding was consistent with the common law rules of vicarious liability. And under those common law rules, only the scienter of employees who commit a torte. Again, it's committing a culpable act, can be imputed to the corporation.

Now, *Southland* was decided before *Janus*. I think that's very important here. So clearly to the extent that the Fifth Circuit thought that furnishing information was a way of making a statement and there can be liability for an individual who does that under the securities fraud laws, that is no longer true now that the Supreme Court has decided *Janus* and made this limitation.

So I don't think *Southland* provides any reason for this Court to depart from its prior rulings. And indeed, as I noted repeatedly now, I think *Janus* makes it clear that this Court shouldn't depart from its prior rulings on this -- on this issue.

The only other thing I would add, Your Honor, before sitting down is to say that the plaintiffs securities fraud

claims against the other individual defendants: Thompson, Pierce, Larson and DeYoung, should now, I think, be dismissed with prejudice. This court dismissed those claims of leave to amend, but plaintiffs haven't had any new allegations concerning those individuals. And as a result, there's really no reason for those claims to remain in the case no matter what the Court otherwise decides on this motion.

THE COURT: Mr. Rabinovitz, I don't think I need to hear from you since nothing in the amended complaint relates to your client.

MR. RABINOVITZ: I agree, Your Honor.

THE COURT: And you would echo what Mr. Roberts just said?

MR. RABINOVITZ: That's correct, Your Honor.

THE COURT: All right. Mr. Barz, I'll hear from you now, sir.

MR. BARZ: Thank you, Your Honor.

I'll start where he ended so we can continue the discussion of corporate scienter. And I'll tell you, Your Honor, what he's asking you to hold, no other Court has ever held.

We've cited several cases rejecting the arguments he just made including that *Janus* somehow speaks to this issue. The Supreme Court decision of --

THE COURT: A Court that considers this issue in the

light of the *Janus*?

MR. BARZ: Yes, I've cited --

THE COURT: Which court does that?

MR. BARZ: Well, I've cited at least two district courts, which is the *Lee v. Active Power* out of the southern district of Texas. And I've cited Judge Pauly of the Southern District of New York in *Pennsylvania Public Schools v. Bank of America*. Both of those district court judges expressly said *Janus* has no bearing on this issue. And I'll explain why.

The Sixth Circuit decision that I make here, by the way, which says "furnishing information is enough" was decided after *Janus*. It didn't mention *Janus*. And the reason is, is because it doesn't apply.

Janus dealt with whether a third party, a supplier, could be liable for the statements in the 10-K. And the Court held "no, that it was not a maker of those false and misleading statements.

The *Janus* Court doesn't even deal with scienter, much less corporate scienter. In fact, courts that have interpreted *Janus* has said it doesn't apply to corporate insiders even with regard to who makes the statements. There's a debate over that. The word "furnish, it's not in *Janus* at all. Scienter, it's not even -- what was on appeal. It's completely irrelevant.

Janus would only apply if we were trying to sue

those lower level people. *Janus* would say, they didn't make those statements if they didn't have ultimate authority over them. What *Janus* does not say is that the corporation, as Your Honor notes, that's an actor. That's a speaker. The corporation made those statements. The question that we're dealing with, which was not at all addressed in *Janus* -- it's not mentioned, it's not addressed at all -- is whose scienter can be attributed to the corporation. And what we're arguing and what we've cited several cases that support, is that it's either the person that says it, or the person that hands them the data that goes into the 10-K and then they repeat it.

THE COURT: So you -- you believe that the Fifth Circuit case correctly states the law and that *Janus* did not either cite or disapprove of the Fifth Circuit case?

MR. BARZ: Correct. And what's important is the Fourth Circuit cites the Fifth Circuit case prior to *Janus*. Which says, if you furnish information, that's enough. Now since *Janus*, the Sixth Circuit has taken a look at the issue and they've explicitly held that you're either the speaker or you furnish information.

Now, this new argument that somehow the Sixth Circuit got it wrong and the Fifth Circuit got it wrong because of *Janus* has been raised twice, to my knowledge, in the two cases I cited and rejected both times. They can't cite you a single case that supports them.

The only case they cite is your decision from Computer Sciences, which predated all of this.

Here is my response on that: One, I don't believe the argument was squarely presented to Your Honor. You won't find the word "furnish information" in your opinion.

THE COURT: That's a kind way of putting it.

MR. BARZ: Well, I think it's fair. I don't think you have to say that I was wrong there. I don't see the word "furnish information" anywhere in that opinion. What I see is a debate about whose scienter can be attributed to the company, but Court's can only --

THE COURT: Well, simply facts that were not presented to me.

MR. BARZ: Courts can only rule on the arguments that are presented. We've presented it here and we've given you the overwhelming authority. And I think if you side with us on that, then clearly, you know -- and the only thing I'll point -- they try to raise some new arguments in their reply brief that weren't squarely addressed, I think those are waived. The issue here is whether you believe, as a matter of law, furnishing information is enough. We argue that it is. They are argue that it's not. We've got all the law on our side. They have none.

Let me back up now, if you will, to the principal accounting officer, unless you'd like me to address anything

else.

THE COURT: Do it quickly.

MR. BARZ: Okay. So, Your Honor, the last time we were here, and we argued this case in here, and I read your opinion. And I understand that you found that we hadn't done enough to meet our burden of pleading a strong inference of scienter. What I didn't get from any of that, either the argument that day or the opinion, is that we were, you know, not even close.

And what I think changes the analysis here now is that we're dealing with the principal accounting officer. This is the company expert on GAAP. The company said it follows the COSO framework from the Treadway Commission, which we've cited those materials. So when you designate someone as your principal accounting officer, that means this is our in-house expert on GAAP. So I think all those allegations we made before and argued before, which I'm not going to repeat, carry extra force as applied to this individual.

When you're dealing with an accounting restatement and I have brought in a salesmen as a defendant, you might look at it one way. But when you bring in the top accountant, you look at the other. That's called common sense, juries are instructed they're allowed to use it in their cases. It's not forbidden in the Fourth Circuit either.

The second thing is we've added additional facts

about him. And what I think this Court has got to be careful with is they dispute those facts, but they're not allowed to.

You'd have to convert it into a motion for a summary judgment. And there's two critical facts that they dispute.

Before I get to that, let me just frame it. With the one thing --

THE COURT: Do it quickly.

MR. BARZ: -- we do agree on, is that the Fourth Circuit in *Zak v. Chelsea Therapeutics*, and they cite this case in their reply brief for the exact same point -- reversed the district court in a securities fraud case because it had failed to construe the documents in the light most favorable to the plaintiffs.

So we've submitted what's new. What we didn't have when we were before you last time because it came out two weeks after our oral argument.

Is the Exhibit 8 -- it's Docket 83, Exhibit 25 to their motion. And it's the company's presentation to investors.

THE COURT: Yes, he referred to that in his argument.

MR. BARZ: It's an update on the restatement. And it says that part of the remediation they took was to terminate the responsible individuals. It also -- in this document, as we've walked it through, it says that one of

those individuals was upgrading the principal accounting officer. And they referred to doing that based on his professionalism.

Now, we think that is a scathing indictment from the company for an individual. This wasn't an individual that left, and they said he's gone on for a better job. This wasn't an individual that left, the company thanked him for his service, which you typically always see when high execs leave companies. Instead, they issued a scathing document that includes him with all the other guys that were fired. And we think it makes sense, and it helped us look at these allegations in a new light, because there's two parts to this restatement.

There's the was it realistic to believe that you could cut cost that much. And they argued that when it comes to estimates, it could be tough, maybe not all the information was passed along. But there is a second piece of the restatement, Your Honor. They said that part of the reason they needed to restate is they weren't counting all the costs. That's not projections into the future. That's not, "well, I thought I could get it done, maybe it was unrealistic." That's just saying, we're not going to count those.

This is the individual that came up with that policy that they admitted at the end they needed to fix and then they fired the guy. We think that's compelling. Not counting all

your costs is indefensible when you are the in-house expert on GAAP. They've cited cases with restatements that deal with complex new rules. They keep mentioning the *Yates* case. *Yates* was a complex new rule dealing with variable interest entities. That's calculus for accountants.

Counting your overhead, that's accounting 101. There's been no change in the accounting rules that they've cited that we're aware of, that said you used to not count them, now you have to. They certainly didn't say that's the case. They said we were doing it wrong, we're now fixing it and going forward. And we've got a new principal accounting officer.

Now, to get around this, they invent a fact. They say that not just one, but two accounting firms explicitly approved doing it that way. Where is the evidence of that? There's no evidence of that. They -- the only evidence they offer for that is they say the policy was fully disclosed. Auditors don't audit every little thing you do. They can't be there 365 days a year. They look at the financial statements as a whole.

There is no opinion they can give you that says, "We approve the exclusion of general and administrative expenses from the calculation of costs under the Lake City contract." They can't cite it because it doesn't exist.

Now, but they want you to assume, for the purpose of

this motion, that it was approved by the auditors before and the basis they give you is they claim that it was clearly disclosed in the 10-K.

Now, we didn't attach the 10-K and they didn't attach the 10-K. They say it was disclosed but they didn't give it to you. I would like to give it to you now. I would like to give it to you after this. But I think if you're going to go and dispute the facts of my motion because I've alleged to the opposite. I said they never disclosed this --

THE COURT: Well, I can consider under Rule 12 the 10-Ks. And it probably won't surprise you to know that we have them.

MR. BARZ: I invite you to.

THE COURT: All right.

MR. BARZ: And I want to point you to the 10-K for the transition period April 1st, 2015 to December 31st, 2015.

THE COURT: Is that one of the 10-Ks that's at issue?

MR. BARZ: That's one of the false and misleading ones before they corrected it.

THE COURT: All right. Show it to counsel.

And hand that to the court security officer. All right.

MR. BARZ: And I turn everyone's attention to page 32. So we've got to read this disclosure in context. It

says: Profits expected to be realized -- this is their policy -- on contracts, are based on management's estimates. Now, that's interesting because we've heard a lot about it was all the low level guys, but that's not what they told investors. They said: Profits expected to be realized on contracts are based on management's estimates of total contracts sales value and costs at completion. Total sales and costs. Not some costs. Not other costs.

Look at what they say in the next paragraph: Changes in contract estimates occur for a variety of reasons including changes in -- and they list several items. The last one is: Contract overhead costs over the performance period.

Well, wait a minute. They just said that we told everybody we didn't include the general administrative overhead costs in calculating the profits in Lake City. It is not at all accurate. The fairest reading of this reference to total costs and changes in overhead costs can affect our estimates is that they are including them. And they changed this language to explicitly say we weren't doing it, now we are.

So if the auditors approved them doing it, why did they make them change it? It makes no sense at all. I mean, I don't even understand that argument that the auditor said we could exclude those costs, but yet they changed it in the end and restated.

So in any event, if you're going to dispute the facts, look at the document and apply the Fourth Circuit standard that you've got to read these things in the light most favorable to the plaintiffs at this stage.

THE COURT: All right. Thank you.

MR. BARZ: Thank you.

THE COURT: Do you have more than a minute and a half?

MR. ROBERTS: I'll try to be as brief as I can, Your Honor. I'll take those points in reverse order very quickly.

THE COURT: Yes, very quickly.

MR. ROBERTS: On the issue of what does the 10-K say about the accounting policy, Your Honor, I can only say that my esteemed opponent here reading of is just completely wrong as a matter of accounting. I mean, it's quite simple. The company disclosed that the entire amount of the estimated gross margin loss is charged to cost to sales. Gross margin loss is a term, you can easily find it on the internet, gross margin doesn't include company wide costs. So when it said that, it was clearly telling people it wasn't including company wide costs as part of its calculation. And I'll leave that there.

On the issue, Your Honor, of this restatement presentation, we provided it to the Court as an exhibit to our motion here. Again, this is a kind of gross misuse of the

documents. I would note that the --

THE COURT: Well, of course, it's referred to in the amended complaint.

MR. ROBERTS: It is.

THE COURT: So I'm entitled to consider it. Go on.

MR. ROBERTS: You absolutely are, Your Honor, but -- but what I'm suggesting here is that plaintiffs have grossly distorted what this document says. We've provided it to the Court. It's clear. There's a page in it. I have it right here. I'm happy to hand it up, Your Honor, if it would be helpful.

THE COURT: All right. You may do so. Show it to opposing counsel, first.

MR. ROBERTS: Of course.

THE COURT: Yes.

MR. ROBERTS: Mr. Barz just argued that this document clearly says that Mr. Thompson was fired as a result of the restatement. It says nothing like that. If you look at first tab, Your Honor, this page called "Background" is the only mention of Mr. Thompson at all in this entire document.

In this page background, it says, down at the final bullet point, "Since 2015..." that would be, of course, prior to the restatement. So this is going back now prior to the restatement. "Orbital ATK has upgraded its finance organization." That says that includes a new principal

accounting officer. That's it. There's no reference here to the restatement, that Mr. Thompson is somehow responsible for it, that he's being let go because of actions related to the restatement. Nothing like that, Your Honor. Nothing.

And so for Mr. Barz to stand up here today and say that this document shows that is just outrageous. I don't have any other way to put it. So I will leave that there.

And then, Your Honor, one final point and I'll sit down. And this goes to this issue of corporate scienter. So Mr. Barz suggested that there haven't been courts that have addressed this. Well, that's because, of course, *Janus* is a quite new decision. In terms of these couple of district courts that have addressed this issue, he said something quite telling, of course, he said *Lee v. Active Power*, is the northern district of Texas case. So what that case simply says is, well, until the Fifth Circuit changes its mind about who makes a misstatement, we're going to continue to find that furnishing information is enough. Of course, this furnish information standard has never been adopted by the Fourth Circuit. This is -- this is -- this is an invention from other courts, not this court.

And the -- the key here, I think the way to think of this is very simply, Your Honor, is the question is who can be liable for making a misstatement? Can lower level employees be liable for that? They can't. The Supreme Court has

answered that question. The only people who make the misstatement are the people who have ultimate authority over it.

So the Courts are consistent. The issue is who makes the statement and then you can impute their scienter to the company.

THE COURT: All right.

MR. ROBERTS: The lower level employees here didn't make any statements.

THE COURT: Thank you.

MR. ROBERTS: Thank you, Your Honor.

THE COURT: The reference to the Texas case causes me to have another reminiscence, which I will keep to 30 seconds.

One of the first arguments I made in the Federal District Court in Norfolk involved a Pullman conductor in a FELA case. And my position on behalf of the railroad, which was Mr. Powell's client, as he then was, I've worked for Mr. Powell as he then was. And I argued to the judge, who is no longer in this vale of tears. I said that the Supreme Court had said that there was no liability. And the judge said, "Well, that may be what the Supreme Court said, but what did the Fourth Circuit say?"

And I kind of looked around. I actually had a family member in the courtroom, so it was a little

embarrassing. And so I looked around and I thought and I said, "Well, the Fourth Circuit did say that." And then I heard one of the more remarkable statements from the bench I'd ever heard. He said to me, "Well, it appears they did say it, but I don't think they meant it."

Well, I will say that about four or five weeks later an opinion came out that did apply the appropriate standard from the Supreme Court and the Fourth Circuit.

So you-all can hope that in the next few weeks, as I consider what you've said, that the light will finally dawn on me in the right way, whether it's for the plaintiff or the defendants.

Thank you for your arguments. They've been very helpful. I'll take them under advisement.

MR. BARZ: Thank you, Your Honor.

MR. ROBERTS: Thank you, Your Honor.

(Proceedings adjourned at 11:17 a.m.)

CERTIFICATE OF REPORTER

I, Tonia Harris, an Official Court Reporter for the Eastern District of Virginia, do hereby certify that I reported by machine shorthand, in my official capacity, the proceedings had and testimony adduced upon the Motion to dismiss in the case of the **STEVEN KNURR, et al versus ORBITAL ATK INC., et al**, Civil Action Number 1:16-CV-1031, in said court on the 8th day of December, 2017.

I further certify that the foregoing 38 pages constitute the official transcript of said proceedings, as taken from my machine shorthand notes, my computer realtime display, together with the backup tape recording of said proceedings to the best of my ability.

In witness whereof, I have hereto subscribed my name, this the December 13, 2017.

Tonia M. Harris, RPR
Official Court Reporter